Report to San Diego City Council

April 16, 2007

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Services Provided

- Gain thorough familiarity with the history and structure of SDCERS
- Replicate Cheiron's June 30, 2005 actuarial valuation
  - Actuarial Accrued Liability: +0.76%
  - Normal Cost Rate: -2.93%
  - Annual Required Contribution: -0.56%

Services Provided

- Study past SDCERS experience relative to actuarial assumptions
- Analyze and compare actuarial methods of calculating liabilities, actuarial methods of smoothing assets and actuarial assumptions
- Illustrate effects of changes in actuarial methods and assumptions

Services Provided

- Assist Audit Department in preparation of June 30, 2003 CAFR
- Determine financial effects of MP1, MP2 and the Corbett Settlement
- Testify in the matter of San Diego City Employees' Retirement System v. San Diego City Attorney Michael J. Aguirre, et al.

Services Provided

- Present report on SDCERS underfunding
- Present report on strategies for pension reform
- Replicate Cheiron's June 30, 2006 actuarial valuation
  - Actuarial Accrued Liability: +0.71%
  - Normal Cost Rate: -0.71%
  - Annual Required Contribution: +0.73%

Services Provided

- Prepare expert report in the matter of San Diego Police Officers' Association v. City of San Diego, et al.
- Evaluate DROP cost neutrality
- Provide cost estimates for labor negotiations

June 30, 2006 Actuarial Valuation

- Able to replicate Cheiron report within plus or minus 0.75% for actuarial accrued liability, normal cost rate and annual required contribution
- IRS guideline is plus or minus 5%
- Conclusion – June 30, 2006 actuarial valuation can be relied upon for accuracy

June 30, 2006 Actuarial Valuation

- Calculation of liability for terminated members entitled to future benefits
  - Assumes those with less than 10 years of service will take refund of accumulated contributions, without reciprocity, and those with 10 or more years of service will take service retirement allowance, subject to reciprocity
  - All are entitled to reciprocity or refund of accumulated contributions
  - Increases unfunded actuarial accrued liability by $16 million and annual required contribution by $0.9 million

June 30, 2006 Actuarial Valuation

- Actuarial value of assets was set equal to market value of assets (fresh start)
  - If fresh start were assumed to occur 4 years earlier, actuarial value of assets would be only $13 million less
  - However, at June 30, 2007, smoothing would consider only one year of experience rather than four years
  - Difference could be as great as $125 million
- Actuarial value of assets increased by $184 million, due to change in smoothing method.

Actuarial Accrued Liability

- Amount dependent upon method of calculation, e.g. Projected Unit Credit (PUC) or Entry Age Normal (EAN), as well as actuarial assumptions
- GASB 27 allows 6 different methods of calculation – Entry Age, Frozen Entry Age, Projected Unit Credit, Attained Age, Frozen Attained Age and Aggregate

Actuarial Accrued Liability

- Entry Age - $5.192 billion
- Projected Unit Credit - $4.983 billion
- Entry Age increase equals $209 million

Unfunded Actuarial Accrued Liability

- Amount dependent upon calculation of actuarial accrued liability and calculation of actuarial value of assets
- Actuarial value of assets
  - Fresh start at June 30, 2006 - $3.982 billion
  - Fresh start at June 30, 2002 - $3.969 billion
  - Conclusion – No material difference at June 30, 2006; however, difference at June 30, 2007 will be material (approximately $125 million understatement)
  - June 30, 2006 fresh start is more conservative

Unfunded Actuarial Accrued Liability

- Unfunded actuarial accrued liability equals actuarial accrued liability minus actuarial value of assets
  - Entry Age - $1.210 billion
  - Projected Unit Credit - $1.001 billion
  - Entry Age increase equals $209 million

Amortization

- 27 years
  - Entry Age - $71 million
  - Projected Unit Credit - $59 million
  - Entry Age increase equals $12 million
- 20 years
  - Entry Age - $86 million
  - Projected Unit Credit - $72 million
  - Entry Age increase equals $14 million
- 20 year Entry Age increase over 27 year Projected Unit Credit equals $27 million

Normal Cost

- Amount dependent upon funding method chosen
  - Entry Age - $70 million
  - Projected Unit Credit - $79 million
  - Entry Age decrease equals $9 million

Annual Required Contribution

- Amount dependent upon funding method chosen
- Equals Normal Cost plus Amortization, with 27 year amortization
  - Entry Age - $70 + $71 = $141 million
  - Projected Unit Credit - $79 + $59 = $138 million
- Entry Age increase equals $3 million

Annual Required Contribution

- Equals Normal Cost plus Amortization, with 20 year amortization
  - Entry Age - $70 + $86 = $156 million
  - Projected Unit Credit - $79 + $72 = $151 million
- Entry Age increase equals $5 million
- 20 year Entry Age increase over 27 year Projected Unit Credit equals $18 million.

Actuarial Assumptions

- Experience Study
- Key assumptions
  - Investment return
  - Inflation rate
  - Salary increase rate
  - Rates of termination
  - Rates of disability
  - Rates of retirement

Actuarial Soundness

- Is SDCERS actuarially sound?
- Yes, because
  - June 30, 2006 funded ratio is 79.9%.
  - The annual required contribution calculates the liability for all participants and beneficiaries, determines the normal cost and amortization payments for the unfunded actuarial accrued liability over a reasonable period and has established a method for determining and amortizing gains and losses.

Actuarial Soundness

- Is SDCERS actuarially sound?
- Yes, because
  - At June 30, 2006, the market value of assets was only $118 million less than the liability of the System, were it to freeze all benefits (97.1% funded ratio).
  - There is no material risk that SDCERS will be unable to pay the benefits which the City has agreed to pay.